



Queensland University of Technology
Brisbane Australia

This is the author's version of a work that was submitted/accepted for publication in the following source:

Christensen, Sharon A. & Duncan, William (2010) Green leases : becoming a reality. *Australian Property Law Journal*, 19(1), pp. 1-11.

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Green Leases – Becoming a Reality

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Only a few years ago there were only a handful of buildings in Australia, mainly leased by or from the Commonwealth Government to which a green lease might have application. Now with the passing of the Building Energy Efficiency Disclosure Act 2010 (Cth) all commercial office premises in excess of 2000 square metres have 12 months from 1 November 2010 to obtain a Building Energy Efficiency Certificate as part of Stage 1 of the Federal Government's National Framework for Energy Efficiency. This significant change has focused attention on changes required to the conditions of leases where the building has a NABERS rating. This article considers material from the United Kingdom, the United States and Canada where there are similar policy changes in play and makes suggestions as to how certain clauses of a standard lease of a commercial office block may be altered to meet this new regime.

1. Context

The passage of the *Building Energy Efficiency Disclosure Act 2010* (Cth) marks an appropriate occasion to review the progress of the introduction of Green Leasing to the Australian market. Upon introducing the Bill into the Federal Parliament in May 2010, Senator Penny Wong, the then Minister for Climate Change, particularly identified the problem of information asymmetry between a lessor and potential lessee in relation to the energy efficiency of commercial office buildings, which places prospective tenants or buyers at a disadvantage in understanding the energy efficiency performance of premises in the market.³ Arising from this asymmetry, the potential effect is a situation of adverse selection where higher quality products are under supplied or driven out of the market because consumers cannot distinguish them from poor quality products.⁴ The scope of this issue has motivated the introduction of the legislation, which aims to provide lessees and sublessees with the opportunity of deciding whether or not to take a lease or sublease in a building once informed of its energy efficiency rating.

It is in the context of the growing number of commercial office buildings with a four or five star NABERS energy rating, either as a result of new construction or retro-fitting, that it is appropriate to

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³ Elibritt Karlsen and Anita Talberg, 'Building Energy Efficiency Disclosure Bill 2010' (2010) 152 *Bills Digest* 1, 5.

⁴ Allen Consulting Group on behalf of the Department of Environment, Water, Heritage and the Arts, *Mandatory Disclosure of Commercial Office Building Energy Efficiency: Regulation Impact Statement* (November 2009) Commonwealth of Australia <<http://www.climatechange.gov.au/en/what-you-need-to-know/buildings/commercial/~media/publications/energy-efficiency/buildings/disclosure-ris.ashx>>.

review the issue of green leases which are inevitably offered to lessees of such buildings.⁵ Compelling the provision of a Building Energy Efficiency Certificate (BEEC) to prospective buyers and lessees of green rated buildings marks the first step towards mandating various other requirements. This is in keeping with the Commonwealth government's policy of gradually enforcing measures to reduce greenhouse gas emissions caused by the commercial sector. Reduction of emissions also relies upon accurate measurement of current emissions. The Minister also indicated, when introducing the Bill, that there was currently no reliable data on the proportion of commercial office stock in Australia built or redeveloped in compliance with energy efficient requirements of the Building Code of Australia. She recognised that whilst the proportion of energy rated buildings was currently low it was growing.⁶ Figures tabled in Parliament indicated that for commercial properties between 2000 square metres and 5000 square metres in size, only 13% had a NABERS assessment for energy efficiency.⁷

Before auditing the progress of green leasing in Australia and examining changes to leasing practices which will be wrought by the broader introduction of the use of these forms of lease beyond the government sectors and into the commercial lease market generally, a few salient features of the *Building Energy Disclosure Act 2010* warrant consideration.

2. The Building Energy Efficiency Disclosure Act 2010

The mandatory disclosure of commercial building energy efficiency was first proposed in December 2004 under Stage 1 of the implementation plan of the National Framework for Energy Efficiency (NREE). This stage produced a Regulation Impact Statement (RIS) assessing a number of options to drive energy efficiency in commercial buildings. The RIS identified a number of factors which were impeding the take up of economically feasible energy efficiency improvements, principally the disadvantage caused by information asymmetries between building owners and prospective lessees in understanding the energy efficiency performance of the building, and the lack of incentive for both lessors and lessees to make energy savings which hindered the uptake of low or no cost opportunities to do so. The RIS recommended the establishment of a statutory regime which required the mandatory disclosure of NABERS energy base building ratings, lessee lighting details and energy efficient guidance for buildings over 2000 square metres being sold or leased. Ultimately, these recommendations have resulted in the passing of the *Building Energy Efficiency Disclosure Act 2010*.⁸

The Act requires that from 1 November 2010,⁹ a corporation must not offer or invite offers to sell, let or sublet a relevant building unless a valid and current BEEC issued by an authorised authority is

⁵ For an excellent article on the difficulties faced in seeking a NABERS rating, see Scott Lambert and Grant Parker, 'The green ratings war – winning strategies' (2009) 25 *Building and Construction Law Journal* 179.

⁶ Explanatory Memorandum, Building Efficiency Disclosure Bill 2010 (Cth) 2.

⁷ Ibid 3.

⁸ For further information on the *Building Energy Efficiency Disclosure Act 2010* which is beyond the scope of this article, see Melinda Graham, 'Building Energy Efficiency Disclosure Act 2010 (Cth) – An iron fist in a velvet glove?' (2010) 24(10) *Australian Property Law Bulletin* 135; Sarah Carlisle and Robert Jamieson, 'Disclosure laws for the energy efficiency of commercial buildings' (2010) 25(3) *Australian Environment Review* 9.

⁹ There is a transitional period for the giving of a full BEEC for a period of 12 months. During this time it will be sufficient disclosure to provide the energy rating for the building. This rating will not have to be registered on the

registered for that building.¹⁰ The obligation applies where there is a contract in existence creating a contingent right or obligation to lease or sublease the building or part of the building and arguably would apply in the case of assignments of lease.¹¹ In these circumstances, the owner or lessor (or sublessor if it is a sublease) must provide the purchaser, lessee or sublessee with a copy of the BEEC as soon as reasonably practicable.¹² The Act applies only to buildings used or capable of being used as an office in excess of an area of 2000 square metres.¹³ It does not apply to leases or subleases for a period of less than 12 months,¹⁴ a building that is less than 2 years old or a strata titled building.¹⁵ Non-compliance with the Act can result in a civil pecuniary penalty of \$110,000 for a body corporate or \$38,500 in the case of an individual.¹⁶ Furthermore each day for which a breach continues is deemed to be a separate contravention attracting a separate penalty.¹⁷

3. Changes Needed to 'Green' A Commercial Lease

On average, a commercial lease of an office building may be for a period of ten to twenty years. If the lease is entered into now, it will continue well into a period when obligations of lessors and lessees in relation to energy efficient requirements may attract greater sanctions than those under the *Building Energy Efficiency Disclosure Act 2010*, which is only the first step towards regulation of this issue. Currently, standard commercial leases place most obligations on lessees and few upon lessors. The recitals of such leases have no stated objects to encourage environmental sustainability, and do not encourage energy efficiency on the part of either party.¹⁸ This may be due to the fact that traditionally the lessee is burdened with most outgoings which represent, in many cases, payments for the supply of different forms of energy to the building.

To create an incentive for both lessor and lessee to co-operate in the conservation of energy in the operation of the building, the traditional lessor/lessee relationship would have to be recast to ensure that leases are structured to create compulsion, incentive and flexibility for both parties to bring about energy conservation.¹⁹ As the demands by all levels of government for energy saving upon both owners and occupiers of commercial buildings become more strident, the granting of incentives to achieve these outcomes will move to compulsion and this evolution will have to be reflected in the leasing relationship.

Building Energy Efficiency Register kept by the Secretary under the Act. During this period it will not be necessary to disclose the tenancy lighting assessment or the energy efficiency guideline.

¹⁰ *Building Energy Efficiency Disclosure Act 2010*, s 11.

¹¹ *Building Energy Efficiency Disclosure Act 2010*, s 5: 'A person is taken to invite an offer to lease the space if the person invites an offer to enter into a contract under which a contingent obligation or right to lease the space would be created.'

¹² *Building Energy Efficiency Disclosure Act 2010*, s 12.

¹³ *Building Energy Efficiency Disclosure Act 2010*, s 3.

¹⁴ *Building Energy Efficiency Disclosure Act 2010*, s 11.

¹⁵ *Building Energy Efficiency Disclosure (Disclosure Affected Buildings) Determination 2010*, ss 4 and 5 (<http://www.comlaw.gov.au/ComLaw/Legislation/LegislativeInstrument1.nsf/framelodgmentattachments/414902D31F3BDB8DCA25776D000304BE>).

¹⁶ *Building Energy Efficiency Disclosure Act 2010*, ss 11, 12(6), 15.

¹⁷ *Building Energy Efficiency Disclosure Act 2010*, ss 4-5, 11, 15.

¹⁸ Mark Hinnells et al, 'The Greening of Commercial Leases' (2008) 26 *Journal of Property Investment and Finance* 541, 544.

¹⁹ Michael Brooks, 'Green Leases and Green Buildings' (2008) 22 *Probate and Property* 203, 203.

In an article in 2007, the current authors recognised that commercial leases as they stood were more conducive to creating adversarial relationships than co-operative relationships and that in a new era of green leases this would have to change.²⁰ That article acknowledged that standard commercial leases did not require a lessor of a multi-tenanted building to make information available to the lessee regarding the overall operational costs of the building. Additionally, these leases did not provide the transparency which would be required for the maintenance of a 'green' building and to facilitate satisfactory communications between lessor and lessee, and between lessees themselves if common goals to reduce energy usage were to be realised.

If certain high standards of energy conservation were needed to maintain the energy rating of the building, this will not only require a commitment to energy conservation by the lessor, but also by all lessees. These lessees will now be aware of the rating through the provision of a BEEC prior to taking up a lease in the building, and will presumably wish to maintain that rating. In this respect, energy performance criteria will have to be established at the outset and agreed upon by the parties.

Not only will the parties to the lease wish to conserve energy in operating the building from day to day, for example, in the use of electricity, gas and water, but in keeping with the spirit of energy conservation in a wider sense, the rating presumes that the materials used in the construction, repair or renovation of the building have been manufactured in an energy efficient manner. This could be achieved through the use of recyclable materials and, where possible, the replacement of inefficient forms of energy creation with renewable forms. There are provisions in leases to permit alterations or improvements with the consent of the lessor and these improvements or alterations might require the removal and replacement of building material. A lessor might now have written into the lease that such approval will not be unreasonably withheld where the lessee certifies that the alterations or improvements will be undertaken with recyclable or energy efficient materials. If the building was originally constructed to achieve a Green Star rating²¹ then a condition of replacement or improvement may be that any changes use materials or building methods necessary to maintain that rating.

Where a lessee or sublessee (including an assignee) has received a BEEC which discloses a certain rating at the time the lease commences, there would be an expectation that such a rating would be maintained and, indeed, if appropriate, improved during the period of the lease. It also implies that the energy usage of all parties with an interest in the operation of the building would be monitored and recorded and that this information be disclosed to those interested parties. There is nothing in the present relationship of lessor and lessee which requires disclosure of any of this information in the absence of an express obligation. In the case of commercial leases requiring the payment of rent and

²⁰ Sharon Christensen and William Duncan, 'Green Leases - A New Era in Landlord and Tenant Co-operation?' (2007) 15 *Australian Property Law Journal* 54; Susan Bright, 'Drafting Green Leases' (2008) 72 *Conveyancer and Property Lawyer* 498, 501.

²¹ Green Star is a national, voluntary environmental rating system that evaluates the environmental design and construction of buildings. The Green Star rating system will provide a rating of 4-6 for a building. For more information refer to <http://www.gbca.org.au/green-star/green-star-overview/> (accessed 28 October 2010).

outgoings separately, information concerning the lessee's share of outgoings is normally made available, but this information is a far cry from making the energy consumption information in relation to the lessor and all lessees available to all parties.

Presently, there is also no financial incentive for a lessee to invest in energy saving plant or equipment, except in so far as it might reduce the lessees' proportion of outgoings for energy used in business operations. However, this is not usually a sufficient incentive to consciously promote conservation of energy in the operation of a building. In the new 'green' regime, it is suggested that there would have to be greater financial incentive for lessees to actively engage in conservation initiatives which would assist in maintaining a building's energy rating or, as previously stated, improving it over a period. For example, a lessee generally has no interest in improving a lessor's property by introducing energy efficient plant or equipment which might remain on the premises after the expiry of the term. Leases are sometimes too short to properly amortise those types of expenditure which offers no current benefit for the lessee during the term of the lease in bringing about a reduction in rental or lowering the proportion of outgoings in a net rental lease that may be payable by the lessee.

It is conceded that there may also be some resistance by lessors to the introduction of 'green' practices. The major issue is that the establishment cost of introducing 'greening' principles is significant in the case of a building which has been retro-fitted. From a lessor's perspective, it may take too long to amortise these costs at the current and projected rental levels over the average period of the lease. Conversely, there could be significant cost savings by the introduction of energy saving innovations which would reduce outgoings and other costs for both lessor and lessees.

4. Negotiating a 'Green' Lease

A 'green' building with a sound NABERS rating is now a more valuable asset than its counterpart without those attributes. It is accepted that energy efficiencies must inevitably reduce the operating costs of a building and increase its market value and revenue stream. Being 'green' may now give a comparative marketing advantage when seeking new tenants and afford the building a special recognition in the market enhancing the marketability of available space. It is true that as more 'green' buildings are constructed and retro-fitted, their presence is offering a certain brand recognition to the owners and these positives are not to be gainsaid. However, there are a number of issues to which a prospective lessee's attention should be drawn before signing up to a 'green' lease. It is appropriate to examine some of the central elements going beyond the parameters of ordinary commercial leases to which account might be taken.

Before considering the imposition of a 'green' lease in any particular building, there are certain threshold issues to be determined. Firstly, it is pointless considering the imposition of 'green' lease terms unless the particular building has a NABERS rating of four stars or above. As the building is

likely to have a BEEC with a certain NABERS rating, there will be a natural impetus to maintain or improve this rating in the future. The issue arises as to whether or not anything might turn on the maintenance of this rating by both the lessor and lessee.

Consideration must be given to the possible situation where the building fails to meet its energy efficiency rating during the currency of any particular lease. It is likely that the energy levels will have to be monitored and that this monitoring must be transparent in respect of all parties. This might be managed by a committee comprising the lessor and a number of lessees through the imposition of an Environmental Management Plan (EMP) to which all parties subscribe in the lease itself. To monitor the operation of the building to the standard required, the parties will have to agree upon an environmental auditor who will have access to all parts of the building on a regular basis to undertake an audit of energy use. It is likely that the cost of this audit will have to be shared between the lessor and lessees in agreed proportion and the audit would have to be agreed upon by the parties to be acceptable as a final record.

A more difficult issue relates to the failure of either side to meet energy saving requirements. This depends upon whether adherence to the EMP is:

- a. a matter of coercion through the mandating of targets; or
- b. a matter of cooperation where the parties, as part of meeting the objectives of the lease, act in concert to use best endeavours to meet shared goals.

In the first model, the parties would have to agree if the failure to meet these requirements is to be treated as a breach of the lease in the normal way, with the standard sanctions following such a breach. Alternatively, the parties may decide to take a different path in the event that one or more parties fail to meet their requirements following an audit of their energy use. It may be possible, in the absence of treating that failure as a breach of the lease, to balance the ledger by requiring the party with the fault to make payment to a compensation fund which would be utilised under the direction of the Energy Management Committee (EMC)²² to maintain the rating of the building during the currency of its operation. This requirement to compensate would not be merely a penalty which would be extracted by the lessor, but instead the payment would be directed into a fund for the benefit of the owner and occupiers of the building for the purpose stated above.

The maintenance of such a fund would be another way of defraying capital investment costs required for upgrades necessary to maintain efficient systems, as opposed to passing this type of cost on to each lessee through each lease. In respect of each lease, there would have to be some agreement upon individual emissions targets in relation to each tenancy and some idea of the physical state of each tenancy at the date of the lease. This information would have to be known by the environmental auditor so that it would be possible to determine whether the benchmarks set in relation to the premises have been maintained. For example, when a lessee is undertaking renovations or improvements with the lessor's consent, an environmental auditor might check that appropriate

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See below at 6.

recyclable materials have been used in that upgrade or that the equipment installed appropriately energy efficient.

The issues considered above would be threshold issues in negotiations and would guide each party in relation to the particular new clause which would have to be introduced to accommodate this changed paradigm.

5. Formulation of an 'Energy Management Plan' (EMP)

Subscription by the lessor and all lessees to an Energy Management Plan is central to the operation of a 'green' building. This Plan should become an integral part of the 'house rules' by which the building is managed and should form part of the disclosures made to any incoming lessee before the lessee becomes bound by a lease. The legal status of the EMP in the context of the lease obligations is of importance depending upon how failures to meet targets set are managed. This issue is considered later under the heading 'Default and Sanctions'.

The EMP should disclose and establish the following:²³

- a. Give details of the types of energy being consumed in the building;
- b. Set out minimum energy consumption targets for the specified period;²⁴
- c. Describe how energy use is being monitored in respect of common usage and individual usage;²⁵
- d. Describe the nature and extent of energy consumption reduction measures being implemented in the building;²⁶
- e. Define the aspirations of both the lessor and lessees to use best endeavours to meet these targets;²⁷
- f. Set out protocols for the recording, keeping and dissemination of data obtained through the monitoring process;²⁸
- g. Indicate short medium and long term goals in relation to energy consumption reduction;²⁹ and

²³ Katherine Oberle and Monica Sloboda, 'The Importance of 'Greening' Your Commercial Lease' (2010) 35(1) *Real Estate Issues* 32, 35.

²⁴ Katherine Oberle and Monica Sloboda, 'The Importance of 'Greening' Your Commercial Lease' (2010) 35(1) *Real Estate Issues* 32, 35; *National Standard Green Office Lease for Single-Building Projects – 1.02-2009* (30 March 2009) Real Property Association of Canada, Schedule "E" Environmental Management Plan 36-37 <http://www.realtac.ca/green-office-leases/>.

²⁵ Tim Power, 'Building Green' (2008) *Law Institute Journal* 42, 44; Department of the Environment and Heritage – Australian Greenhouse Office, *Essential Elements of an Energy Management Plan for Green Lease Schedules* (August 2006) Australian Government <http://www.climatechange.gov.au/government/initiatives/~media/publications/eego/emelements.ashx>.

²⁶ *National Standard Green Office Lease for Single-Building Projects – 1.02-2009* (30 March 2009) Real Property Association of Canada, Schedule "E" Environmental Management Plan 39 <http://www.realtac.ca/green-office-leases/>.

²⁷ *National Standard Green Office Lease for Single-Building Projects – 1.02-2009* (30 March 2009) Real Property Association of Canada, Schedule "E" Environmental Management Plan 40 <http://www.realtac.ca/green-office-leases/>.

²⁸ Tim Power, 'Building Green' (2008) *Law Institute Journal* 42, 44.

- h. Establish an Energy Management Committee (EMC),³⁰ including its constitution, membership, objectives and functions including meeting frequency and powers.

It should be noted that this information is in the form of a plan and does not prescribe individual responsibilities or penalties for failure to meet these targets. The pivotal question is whether these desiderata take effect as mere aspirations or become part of the obligations crafted by the lease. It is important that any penalties which are agreed upon will provide sufficient incentive for both parties to comply with the lease terms and achieve environmental targets.³¹ Before considering this issue in the proper context of 'Default and Sanctions',³² it is appropriate to consider how a 'green' lease may differ from a traditional lease.

6. Role of Energy Management Committee

As previously stated an Energy Management Committee (EMC) would be established as a part of the EMP. The membership of this Committee would comprise the lessor (and the lessor's representatives with responsibility for the operation of the building) and a number of lessees representative of the spread of lessees, dependent upon the extent and nature of the different tenancies. The primary responsibility of the EMC would be to monitor the lessor's and all lessees' compliance with the EMP which would include the compliance of their agents, invitees and contractors. It is this Committee which would have access to the data relating to the environmental performance of the building necessary to maintain the rating. Operationally, the Committee would approve any repairs, alterations or extensions to the building which were to be undertaken to ensure compliance with policy.

Another key role of the Committee would be to ensure that the EMP was current in its requirements and monitor changes to legislative and best practice standards to ensure that the owner and occupants of the building were kept abreast of important changes. Part of its role would thus be educational, of particular importance with respect to incoming lessees. The Committee would take responsibility for the manner of implementation of new policies to which the owner and occupiers may become subject as a result of changes in the law which may also necessitate changes to the EMP. Consequently, changes to energy consumption targets in the EMP may need to be made and all material parties notified.

The EMC would have responsibility to liaise with external parties including government agencies and other parties. For example, the Committee would bear the responsibility of liaising with contractors engaged by the lessor or any lessee in relation to material changes to the tenancy, to ensure that they

²⁹ Katherine Oberle and Monica Sloboda, 'The Importance of 'Greening' Your Commercial Lease' (2010) 35(1) *Real Estate Issues* 32, 35; *National Standard Green Office Lease for Single-Building Projects – 1.02-2009* (30 March 2009) Real Property Association of Canada, Schedule "E" Environmental Management Plan 36 <http://www.realpac.ca/green-office-leases/>.

³⁰ Also known as a Building Management Committee.

³¹ Rebecca Campbell, Brad Jessup and Tim Power, 'Lease arrangements for green commercial buildings' (2004) 19(3) *Australian Property Law Bulletin* 31.

³² See below at 8.

were properly certified to undertake the work, they understood that an EMP was in operation and that they, too, observed its requirements.

Finally, the Committee would have oversight of the publication of any regular (annual) report of energy usage when the data became available and was compiled. This data would be published to the owner and occupiers as part of the process of making information of the annual targets available and advising upon the performance of the building in the previous period (which would likely be the previous year).

7. Modification of Existing Clauses

A number of conventionally accepted clauses in existing leases would have to be modified to meet the occasion of the introduction of a 'green' lease as well as the inception of 'new' clauses. Although the 'green' lease would deliver a leasehold estate to the lessee for a fixed period and would contain a number of standard clauses, the modified terms would essentially change the conventional, adversarial type relationship between lessor and lessee and lead to a new era of co-operative property owning. The clauses below have been selected upon the basis that each would have to be considered in developing a true 'green' lease model, and if necessary, differently cast.

(a) Rent and rent review

Rent is normally reviewed upon the basis of a percentage increase, a movement in the Consumer Price Index or an expert's opinion of market rent based upon stated criteria.³³ From the lessor's point of view, the principal objective is to ensure that the value of the premises as an investment is not only maintained but increased in line with other market movements in the general economy. Often the stated assumptions that an expert valuer must take into account are artificial so that the final result is a distortion of reality contrived to bring about a result which favours the lessor.³⁴ None of these factors, such as market incentives, a presumed occupancy rate of the building and the rent for comparable premises, goes to the efficient management and operation of the building. A lessee's performance as a tenant has not traditionally been an issue in the revaluation of rent, nor indeed the lessor's performance as a landlord an issue.

In a 'green' lease, the emphasis would have to be different. If the parties have agreed to maintain an energy performance rating, a large part of this would depend upon the lessee's performance as an energy conservationist. Consequently, if the lessee's prudence in the utilisation of the resources in the building assists in bringing down the overall operational costs, there is no reason why this should not be reflected in the amount of rental charged from time to time. Thus, it seems appropriate and

³³ *MFI Properties Ltd v BICC Group Pension Trust Ltd* [1986] 1 All ER 974, 975.

³⁴ *Re McCafferty* [1994] 2 Qd R 538, 557-558.

equitable that the lessor and lessee' energy performance rating for the period preceding the review be taken into account under a 'green' lease.³⁵

On another note, once a price is placed upon carbon through a market based scheme, credits gained by the lessor as a result of ownership of a 'green' building should be allocated to those lessees who are meeting their targets and information concerning this should be made available to the rent reviewer.

Any relevant clause should acknowledge that whilst the lessor in the first instance should be entitled to all carbon offset credits gained as a result of the efficient operation and management of the building (excluding those available only to lessees individually), the lessor should make a reasonable allocation of credits to lessees in the building. What form this takes is a matter of negotiation. This process should take account of the costs of certifying and auditing costs which are not otherwise accounted for in other parts of the lease.

(b) Repair and alterations

The standard repair clause normally requires the lessee to keep the premises in 'good and tenantable repair' with some stated exceptions such as fair wear and tear and damage caused through acts of God. The concept of repair of necessity might involve the importation of new fittings or materials into the premises provided they are not too extensive.³⁶ Again, whilst the state of repair might be measured against the 'age, character and locality of the building',³⁷ this is the only standard by which the need to repair might be judged and the only indicator as to the quality of the repair.

However in a 'green' building the nature and quality of the materials (recyclable, allergy free etc) constituting both the demised premises and any common area (in the case of multiple lettings) would be of critical importance in maintaining the energy rating of the building. Therefore, any replacement material utilised in repairs would have to meet that same standard. The standard would have to be clearly specified in the lease and this benchmark would set the requirements for the satisfaction of this obligation. Whether this would extend to the requirement for engagement of approved builders and installation engineers may also be an issue. There should be provision for an audit of the improvements and certification that they have been made within the letter of the Energy Management Plan.

Similarly, the lease may provide for alterations to be permitted with the consent of the lessor, whether qualified or not. The same principles as are relevant to repairs in respect of materials used would apply to alterations and, as currently, subject to plans approved by the lessor. Where a clause permits alterations subject to the lessor's consent, such consent is not to be unreasonably withheld. There

³⁵ Garry Brett, 'Sustainable Demand' (12 April 2008) *The Estates Gazette* 96.

³⁶ *Lurcott v Wakeley and Wheeler* [1911] 1 KB 905, 915.

³⁷ *Proudfoot v Hart* (1890) 25 QBD 42, 55.

may be a statement in the lease to the effect that consent will be deemed to be unreasonably withheld where the lessee does not use materials consistent with the 'green' rating of the building.

(c) Outgoings

Outgoings are charged separately in net rent leases which are the more common types of lease in large commercial buildings. The lessee will normally pay outgoing based upon the proportion that the area of the leased premises bears to the gross lettable area of the whole building. Where the outgoing is supplied in bulk to the lessor and then proportion paid by the lessees in the manner described without any regard to individual usage, there is little incentive to reform use practices and there may be unfairness in the imposition of the costs. This would be particularly so where one lessee was profligate in their energy consumption and another was frugal.

Some outgoing relate to service charges for energy supplied to the building by several providers, in particular electricity, gas, water and other charges such as air conditioning which relate to machinery owned and maintained by the lessor at the proportionate expense of the lessees. In ordinary commercial leases, the cost passed on for this service does not have to be 'reasonable'³⁸ in the sense that the lessee has no control over the nature of the plant nor whether it is efficiently operated by the lessor in the building. Thus, whilst the extent of the outgoing may be negotiated by a lessee, the quantum which varies from time to time as charges increase is not so negotiable.

One of the objectives of operating a 'green' building is to reduce the costs of operation at the same time as reducing the carbon footprint of the building. Whilst this partially may be due to design features, the quality of the equipment servicing the building and the method of its operation would also be critical to meeting energy targets. It is submitted, upon the condition that each tenancy in a 'green' building is separately metered, that there should be some incentive for a lessee who uses energy sparingly and this should be reflected in a formula for reductions in outgoing.

If a price is placed upon carbon through the imposition of a carbon tax, consideration must be given to whether the carbon tax or carbon offset costs payable by the lessor as a consequence of building ownership should form part of the outgoing of the building. If the objectives of the lease include the conservation and reduction of energy and this objective is achieved over the life of the lease, this should be reflected in a reduction in carbon tax and offset costs benefitting both parties.

The other contentious outgoing might be a contribution to the cost that the lessor incurs by retrofitting the building over a period of time through equipment upgrades to improve the overall environmental performance of the building. Where decorative or cosmetic upgrades are made to a building over time, the effect of these may be reflected in the higher rent charged. However, where, for example, the installation of a more energy efficient air conditioning system might save the lessor in operating

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Bandar Property Holdings Pty Ltd v JS Darwen (Successors) Ltd [1968] 2 All ER 305, 309.

costs, thus benefitting the lessees in a reduction of out goings, the question arises of whether the capital cost of the replacement should be partly amortised by a contribution made to this improvement by the lessees through the outgoings collection mechanism.

(d) Lessor's right to enter, view and rectify

In all commercial leases, there is an express provision which reserves the right to the lessor or its agents to enter and view the demised premises to ascertain the state of repair upon giving a specified period of notice. This clause would have to be enlarged to incorporate the right of the lessor and possibly the EMC, consistently with the EMP, to enter to view the extent of compliance with that plan. Conveniently, this should take place at regular intervals, for example, annually at the time that the environmental audit is being conducted for the entire building. Coupled with this right of entry might be the right of the lessor or the EMC to undertake works upon the demised premises where it is discovered that the lessee who may have undertaken works has not met the standard required by the EMP in the execution of those works.

(e) Waste disposal

In multiple tenanted buildings, the lessor manages the overall waste disposal plan which requires waste in its various forms to be brought to a central pick up area. Different forms of waste, for example, recyclable and non recyclable are normally placed in separate containers for removal by different contractors. Individual lessees may employ their own cleaning contractors to clean and remove their waste from their own tenancy to the central point in the building. An EMP in a 'green' building would require that these contractors adopt appropriate waste disposal practices in accordance with that plan and utilise non toxic agents in the cleaning process within the individual tenancy. From the lessor's point of view, the waste contractors employed by them to remove waste from the entire site would have to be identified and would have to certify that they meet the necessary requirements in relation to the disposal of different forms of waste compliant with all regulations governing this activity beyond the building.

(f) Removal of fixtures

At the expiry of a tenancy, all commercial leases require that the lessee remove its fixtures and fittings to meet the requirement to deliver up the demised premises in good repair and condition. The meeting of this obligation may require the lessee to remove partitions, flooring material, custom built furniture and fittings which are specific to the operation of the lessee's business. Some of this material may be able to be recycled. There should be a firm obligation upon the lessee to recycle material removed in this phase of the lease, in accordance with the overall EMP governing the operation of the building.

(g) Confidentiality

Although most commercial leases do not contain a confidentiality clause where there are side agreements with respect to rental, there is an obligation upon all parties not to disclose the contents as this may affect the rent review process. The proper operation of a 'green' lease may mean that information about the performance (or non performance) of the building as an energy saver may be available to parties outside the owner's circle. It would also mean that information about the energy use by each lessee, their adherence to the EMP and other information gleaned through the environmental audit would be available in respect of the building. Whilst in respect of a certain class of office building, the BEEC will inform a prospective buyer or lessee of the energy performance of the entire building, the information given in that certificate will not descend to the particularity required to manage its performance from day to day. Other documents such as the EMP and compliance reports will give such particularity.

For these documents consideration might need to be given as to whether certain information therein in respect of individual lessees might remain confidential to the immediate parties concerned, the Management Committee and any environmental auditor, professional adviser, consultant or insurer who may have a direct interest in having access to the information.

(h) Assignment and subletting

One of the principal objectives of the EMP is to maintain (or improve) the energy rating of the building from time to time. To a large extent, this depends upon the parties to the lease subscribing to the explicit goals set out in the EMP. Obviously, from time to time assignment of lease and sublettings will change the composition of the individual lessees. It is in the interest of those remaining that any incoming lessee not only subscribes to these goals but is capable through the conduct of their business of meeting those goals. Whilst the BEEC will inform the incoming lessee of the energy rating of the building and the terms of the lease will inform that party of the terms and conditions of the lease, the question arises as to whether the lessor's consent to assignment or subletting should be expressly conditioned upon being satisfied that the prospective lessee can meet their environmental obligations as well as those financial and use obligations of continuing concern to a lessor considering consent. More particularly, the fundamental question is whether the lease should be explicit in stating that the lessor might reasonably withhold consent to an assignment or subletting if the proposed assignee or sub lessee cannot guarantee compliance with the EMP. Unless this consideration is express the lessor may not be able to take this into account when considering if consent should be given.

8. Default and Sanctions

(a) Who recommends enforcement?

The ability to enforce standards is central to the effectiveness of the EMP. It is not only in the interest of the lessor that 'green' standards are enforced but also in the interest of all lessees if both parties stand to benefit financially from that action. Under a standard commercial lease for a multiple tenanted building, whilst both lessor and lessee do have legally enforceable rights, the whip hand lies with the lessor who enjoys contractual relations with all parties. However, it may not be the lessor alone who determines whether a lessee is delinquent in maintaining environmental standards as required by the EMP. This is because the lessor itself may also fail to meet its obligations which may have a deleterious effect upon the financial affairs of all lessees. Therefore, the issue of who might determine whether there is default, and who may recommend action to whom in that event, is crucial.

Under the conventionally accepted model,³⁹ it is the EMC who monitors compliance by all parties, is the recipient of all the information garnered through the monitoring process and oversees the regular audits. The 'green' lease establishes a new paradigm where all relevant information relating to lessee behaviour does not lie within the lessor's sole reach and control. Therefore, in accordance with the spirit of the leasing objectives, it should be the Committee which recommends action against any party for failure to meet the agreed standards. It should be made clear to all subscribers to the EMP at what stage remedial action might be recommended by the Committee and to whom the recommendation might be made. Commercial leasing experience indicates that the recommendation would be made to the lessor to take appropriate action.

(b) What action?

Most of the Australian and international literature on this subject, principally Canadian and from the United Kingdom,⁴⁰ suggest in the first instance a 'softly softly' approach with a view to the defaulting party undertaking supervised remedial action and upon failure to do so be dealt with by alternative dispute resolution means.

If at the 'light green' end of the spectrum, the meeting of performance targets is seen as aspirational only, then no enforcement mechanism is necessary beyond an informal communication to the lessee to the effect that this has occurred and giving some advice as to how it should be rectified over a nominated period. However at the other, 'dark green' end of the spectrum, if a breach is to be visited

³⁹ Commonwealth Department of Climate Change and Energy Efficiency, *Green Lease Schedules* (14 September 2010) Australian Government, Clause 3 <http://www.climatechange.gov.au/en/government/initiatives/eego.aspx>. The EMC is referred to as a 'Building Management Committee' in the Green Lease Schedules.

⁴⁰ Susan Bright, 'Going Green' (2008) 158 *New Law Journal* 1; Mark Hinnells, 'Greening the commercial leasehold relationship' (2010) *Conveyancing and Property Lawyer* 487; *Green Lease Toolkit*, Better Buildings Partnership http://www.legalandgeneralgroupcsr.com/supporting_docs/Green_Lease_Toolkit.pdf; Susan Bright, 'Drafting green leases' (2008) 72 *Conveyancer and Property Lawyer* 498, 507; Nicola Darby, 'Green leases: some positive thoughts' (2008) *Landlord and Tenant Review* 160, 162.

by sanctions the meeting of the performance standards by each lessee should constitute an obligation under the lease. Breach of the obligation will allow appropriate action to be taken at the pinnacle of which would be the forfeiture of the lease.

The middle ground would be represented by a position where the lease would not be subject to forfeiture but where the aberrant lessee might be required to pay compensation in the event of a failure to meet standards. This alternative might suggest the establishment of a 'Sustainability Fund' into which the compensation would be paid to finance future upgrades to the building under the direction of the EMC, who would manage this fund. Given the nature of the lease it would be inappropriate to require compensation to be paid to the lessor as any financial consequence sustained through the loss or lowering of the building's rating would be borne by all parties associated with the building. Alternatively, the compensation could be measured by the cost required to bring the building back to its original rating, or in individual cases, the cost of rectification required in any particular tenancy to the same effect. The failure to pay this compensation might constitute a breach of the lease giving rise to the usual lessor remedies in order to ultimately give the demand some weight.

The Commonwealth remedial provisions in the 'Green Lease Schedule' allow for a non compliant party to be served with a 'Remedial Notice' and the parties meeting with the delinquent lessee to formulate a remedial plan of action. Failing agreement in this respect, the plan would be settled by an independent expert. It is only after failure at this stage that the lease would allow for a Notice to Remedy Breach to be issued (which in most cases in most jurisdictions) allows for a demand for compensation to be made upon the basis that the breach can be remedied. In this event, any lessee who might be charged with a breach of the lease, even a condition stated to be an essential condition, will still have the right to relief against forfeiture should the breach be rectified at the time court action might be taken.

These measures presume it is going to be one of the lessees who are charged with failure to comply with the performance standards, when it could be the lessor who also has obligations in this respect and whose failure may be more damaging overall to the performance rating of the building. Presuming that a decision relating to the failure to meet energy saving targets is made by the EMC of which the lessor is a member, whilst the Committee could recommend the service upon the lessor of a remedial notice, if the issue persisted the persons affected, notably the lessees, could not ultimately take action to eject the lessor. The only possible remedy against a defaulting lessor would be compensation.

9. Conclusions

Michael Brooks,⁴¹ commenting upon the introduction of 'green' leases in Canada, speaks of the barriers to efforts by lessors aiming to make their buildings more energy efficient, which include the expense of establishing or retro-fitting a 'green' building and the long-term cost amortisation period. He also mentions the apathy of lessees whose relationship with the property is generally of short duration aided by the lack of incentive in existing leases and the lack of statutory compulsion by government to enforce standards commensurate with the government's aspirational policies.⁴²

Certainly, these comments could apply equally in Australia although there are signs that the government will use relatively innocuous legislation such as the *Building Energy Efficiency Disclosure Act 2010* to raise awareness of the importance of ratings and energy efficiency and slowly tighten up requirements and sanctions so as to ultimately mandate measures to bring about that result. At present only a small proportion of buildings meet any ratings standard⁴³ and 'green' leases are still a novelty in the market place. With increasing client and tenant demand⁴⁴ for corporate social responsibility and the financial incentive in the form of increased profits to show such responsibility, 'green' leases will likely become more commonplace as corporations strive to show a public commitment to environmental conservation.⁴⁵

It remains to be seen with what celerity the government will act to move from suggestive to mandatory regulation backed by sanctions, but this will inevitably occur over a period if greenhouse emissions are to be reduced.

If this occurs, any commercial lease would have to reflect that changed context. Currently, we are somewhere on the regulatory spectrum between recommendation and strict compliance. As Building Codes tighten to meet the challenges posed by environmental responsibilities, so will the manner of operation of buildings and this factor will reflect more evidently in leasing documentation.

⁴¹ 'Green Leases and Green Buildings' (2008) 22 *Probate and Property* 203.

⁴² Ibid 209.

⁴³ For example, Council House 2 in Melbourne

(<http://www.melbourne.vic.gov.au/Environment/CH2/Pages/CH2Ourgreenbuilding.aspx>) and several other buildings in Melbourne and Sydney: 'Environmental Design Showcased in two Melbourne Buildings' (2006) 21(4) *Australian Environment Review* 10; 'Melbourne green stars shine on Sydney' (2006) 21(4) *Australian Environment Review* 11. See 'Investors more willing to pay a premium for sustainability' (2010) 25(1/2) *Australian Environment Review* 16.

⁴⁴ Susan Bright, 'Going green' (2008) 158 *New Law Journal* 1, 3; Mark Hinnells, 'Greening the commercial leasehold relationship' (2010) *Conveyancing and Property Lawyer* 487, 495.